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CASE COMMENT

ALASKA TEXTILE CO., INC. v. CHASE MANHATTAN BANK, N.A.: THE SECOND CIRCUIT RAISES UNANTICIPATED RISKS FOR LETTERS OF CREDIT

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I. INTRODUCTION

Letters of credit provide buyers, sellers, and banks with certainty¹ and security² in international business transactions.³ The letter of credit functions as the contemplated means

1. See generally *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 464-65 (2d. Cir. 1970) (stating that assurance is a primary goal of letters of credit); *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1543 (S.D.N.Y. 1985), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); Arthur Fama, Jr., Note, *Letters of Credit: The Role of Issuer Discretion in Determining Documentary Compliance*, 53 *FORDHAM L. REV.* 1519, 1519 (1983).

2. *New York Life Ins. Co. v. National Bank & Trust Co.*, 378 A.2d 562, 566 (Conn. 1977) (stating that letters of credit function as security for payment from a solvent buyer); INTERNATIONAL CHAMBER OF COMMERCE, GUIDE TO DOCUMENTARY CREDIT OPERATIONS: INCLUDING UNIFORM CUSTOM AND PRACTICES FOR DOCUMENTARY CREDITS 6 (International Chamber of Commerce Publication No. 415, 1985) (stating that letters of credit offer parties security in the transaction).

3. Sellers can avoid three risks by requiring their buyers to obtain letters of credit: (1) the buyer's insolvency, (2) the buyer's good faith dissatisfaction with the

by which the parties' expectations will be met.⁴ Ideally, the seller expects to be and is promptly paid after its shipment of goods and presentment of conforming documents. The buyer expects and, indeed, receives the goods after reimbursing the payor and presenting the documents to the shipper.⁵

Courts have enhanced certainty and predictability by holding that where the Uniform Customs and Practice for Documentary Credits (UCP) is silent or ambiguous, parties may resort to analogous provisions of the Uniform Commercial Code (UCC).⁶ Specifically, a majority of U.S. courts have construed UCP article 16(c)'s "reasonable time" for an issuer to dishonor a letter of credit as three banking days, analogous to the UCC.⁷ Recent-

goods, and (3) the buyer's wrongful rejection of the goods. *Fama, Jr.*, *supra* note 1, at 1521; *see also* JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* § 19-1, at 806 (3d ed. 1988) (stating that letters of credit help sellers reduce risks of releasing goods prior to payment); Neil J. Rubenstein, *The Issuer's Rights and Obligations Under a Letter of Credit*, 17 UCC L.J. 129, 130 (1984) (noting that letters of credit help avoid delivery without payment).

The letter of credit allows the buyer to avoid the risk of paying for goods that might never arrive due to loss, destruction, or nondelivery. Henry Harfield, *Who Does What to Whom: The Letter of Credit Mechanism*, 17 UCC L.J. 291, 295 (1985).

4. Robert M. Rosenblith, *Seeking a Waiver of Documentary Discrepancies from the Account Party: Unexplored Legal Problems*, 56 BROOK. L. REV. 81, 82 (1990).

5. *Id.* at 83; *see also* WILLIAM C. HILLMAN, *LETTERS OF CREDIT: CURRENT THINKING IN AMERICA* 3-4 (1987).

6. *See* *United Bank, Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254 (1976); *Algemene Bank Nederland, N.V. v. Soysen Tarim Urunleri Dis Ticaret Ve Sanayi, A.S.*, 748 F. Supp. 177, 181 (S.D.N.Y. 1990) (applying UCC by analogy to credit subject to UCP); *Prustcher v. Fidelity Int'l Bank*, 502 F. Supp. 535 (S.D.N.Y. 1980) (authorizing application of UCC to a UCP letter of credit); *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1542 (S.D.N.Y. 1985) (utilizing UCC by analogy), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); *Banque De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.* 787 F. Supp. 1416, 1421 (S.D. Fla. 1991), *aff'd*, 959 F.2d 971 (11th Cir. 1992); *see also* Charles del Busto, *Operational Rules for Letters of Credit: Effect of New Uniform Customs and Practice Rules*, 17 UCC L.J. 298, 303 (1985) (suggesting that the United States uses UCC terms to define UCP); Robert M. Rosenblith, *What Happens When Operations Go Wrong: Enjoining Letter of Credit Transaction and Other Legal Stratagems*, 17 UCC L.J. 307, 309 (1985) (noting that if the UCP is silent, bankers look to the UCC). *But see* *Fertico Belgium, S.A. v. Phosphate Chem. Export Ass'n*, 473 N.Y.S.2d 403, 405 (1st Dept. 1984) (subjecting credit to UCP makes UCC inapplicable); WHITE & SUMMERS, *supra* note 3, § 19-1, at 807 n.3 (stating that UCP complements UCC, but sometimes displaces it).

7. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1141; (S.D.N.Y. 1991), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 821 (2d Cir. 1992); *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1539 (S.D.N.Y. 1985) (finding three days the maximum allowable time), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); Rosenblith, *supra* note 6, at 330 (noting that the three-day

ly, however, the Second Circuit reasoned that article 16(c)'s "reasonable time" was not ambiguous, and declined to apply the UCC's three-day rule.⁸

In September 1988, Alaska Textile Company sued Chase Manhattan Bank in the New York Supreme Court, alleging the bank wrongfully dishonored letters of credit⁹ by violating the timely notice provisions of the UCP.¹⁰ Chase Manhattan Bank removed the action to the U.S. District Court for the Southern District of New York.¹¹ The district court dismissed the action.¹² The court reasoned that, while the common practice in New York was to construe the UCP's requirement of "reasonable time" as meaning three banking days, Alaska Textile had waived Chase Manhattan Bank's otherwise requisite compliance with the UCP by submitting the documents on an approval basis.¹³

On December 28, 1992, the U.S. Court of Appeals for the Second Circuit affirmed on different grounds.¹⁴ The Second Circuit held that (1) Alaska Textile did not waive Chase Manhattan Bank's compliance with the UCP, and (2) Chase Manhattan Bank acted on Alaska Textile's demand within the reasonable time mandated by article 16(c). *Alaska Textile Co., Inc. v. Chase*

period of UCC 5-112 is likely to be a reasonable time for the UCP).

8. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 821 (2d Cir. 1992).

9. *Id.* at 817.

10. *Id.* at 818. Article 16(c) of the UCP states that "[t]he issuing bank shall have a *reasonable time* in which to examine the documents and to determine . . . whether to take up or to refuse the documents." U.C.P. art. 16(c) (1983) (emphasis added). Once the issuer decides to either take up or to refuse the documents, it must "without delay" provide notice of the discrepancies in the documents. U.C.P. art. 16(d) (1983). The relevant portion of article 16(d) of the UCP provides:

If the issuing bank decides to refuse the documents, it must give notice to that effect *without delay*, by telecommunication or, if that is not possible, by other expeditious means, to the bank from which it received the documents (the remitting bank), or to the beneficiary, if it received the documents directly from him.

U.C.P. art. 16(d) (1983) (emphasis added).

11. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

12. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1139 (S.D.N.Y. 1991), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 821 (2d Cir. 1992).

13. *Id.* at 1141.

14. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 815 (2d Cir. 1992).

Manhattan Bank, N.A., 982 F.2d 813 (2d Cir. 1992).

It is against the backdrop of desired commercial assurances that the *Alaska Textile* court, without providing adequate support for its rationale, raised unanticipated risks in the international trade context by rejecting the three-day rule. The Second Circuit's decision disrupted the parties' expectations, was contrary to the precedent of a number of U.S. jurisdictions, and discounted the importance of an issuer's obligation as entirely independent of the underlying transaction. As a result, the court failed to place the loss on the best cost-avoider, the issuer.

This Case Comment demonstrates the impact of *Alaska Textile* by exploring the operational rules governing letter of credit transactions, the jurisprudence construing letter of credit law, and the subsequent developments emanating from the decision.

II. PERSPECTIVE

The letter of credit¹⁵ provides buyers and sellers with certainty in commercial transactions by replacing the face-to-face sale with an exchange of documents.¹⁶ A commercial letter of

15. The origins of the law governing letters of credit have varied throughout the world. See HENRY HARFIELD, LETTERS OF CREDIT 2-3 (1979). The legal framework of letters of credit in Anglo-American jurisprudence stemmed from decisional law. *Id.* In the United States, the rules governing documentary credit transactions developed from landmark decisions rendered in the early part of the 20th century. *Id.* Letters of credit in Latin America and Europe were recognized first by statute and commercial code. See generally BORIS KOZOLCHYK, COMMERCIAL LETTERS OF CREDIT IN THE AMERICAS 44, 58 (1966).

16. As an example, assume that a Venezuelan buyer wants to purchase goods from a seller in the United States. The seller is concerned, in light of the distance between them, with the buyer's credit-worthiness. At the same time, the buyer wants assurance that the seller will deliver the goods.

Addressing these concerns, the seller (Beneficiary) requests the buyer (Customer) to have his or her bank (Issuer) in Venezuela execute a letter of credit, with a specific expiration date, in Beneficiary's favor. The credit requires that upon Beneficiary's delivery of goods to a shipper, accompanied by a precise presentation of certain documents specified in the credit to its local bank, Beneficiary will receive payment.

Beneficiary's local bank may be a confirming bank, an advising bank, or a collecting bank. If the local bank is an advising bank, its obligation is to act as an agent for Issuer and Customer and to give notice of the establishment of a credit in Beneficiary's favor. If the local bank is a confirming bank, it is directly obligated on the letter of credit, as if it were the issuer. The confirming bank pays Beneficiary and forwards the documents to Issuer for reimbursement. If the local bank is a

credit involves three independent legal relationships.¹⁷ These are the buyer and seller's underlying sales contract,¹⁸ a customer and issuer's agreement to execute a letter of credit,¹⁹ and an issuer and beneficiary's obligations under the letter of credit itself.²⁰

Perhaps the most unusual and commercially attractive feature of the three separate arrangements is that the issuer's duty to pay the beneficiary is wholly independent of the underlying sales contract.²¹ The reliability of the letter of credit is preserved through this independent duty because the issuer is concerned only with documents, rather than the quality or fate of the goods.²²

Because the letter of credit is a private, legal arrangement, its terms provide the primary source of law.²³ In addition, the parties can specifically incorporate trade usage, case law,²⁴ and

collecting bank, the documents are typically collected and submitted for Customer's approval, and are no longer subject to the letter of credit.

Regardless of which role the local bank plays, Customer ultimately reimburses Issuer in Venezuela, in exchange for the documents which Beneficiary previously presented. It is only with those documents that Customer can receive the goods upon their arrival by carrier in his or her country.

The facts for this hypothetical are based on an example from HILLMAN, *supra* note 5, at 3-4.

17. See generally Rev. U.C.C. § 5-103 cmt. 3 (1990).

18. See Henry Harfield, *Who Does What to Whom: The Letter-of-Credit Mechanism*, 17 UCC L.J. 291, 293 (1985) (noting only seller and buyer are parties to that contract).

19. *Id.*

20. *Id.* See generally Rosenblith, *supra* note 6, at 307-08 (discussing the independent nature of three distinct agreements).

21. Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 814 (2d Cir. 1992) (examining documents utterly independent of sales contract); Trudor Dev. Group, Inc. v. United States Fidelity & Guar. Co., 968 F.2d 357, 360 (3d Cir. 1992) (resolving dispute regarding sales contract done with money in beneficiary's hand); B.E.I. Int'l, Inc. v. Thai Military Bank, 978 F.2d 440, 442 (8th Cir. 1992) (considering buyer-seller dispute outside of issuer's duty to pay); Ward Petroleum Corp. v. Federal Deposit Ins. Corp., 903 F.2d 1297, 1300 (10th Cir. 1990) (requiring documentary examination without reference to course of dealing or performance of parties to underlying contract); see also Rubenstein, *supra* note 3, at 130 (noting that the underlying purpose of issuer is to function as a neutral party to the sales contract).

22. Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co., 612 F. Supp. 1533, 1537 (S.D.N.Y. 1985), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); see also Fama, Jr., *supra* note 1, at 1520 (stating that bank's role is to examine the documents).

23. See generally Harfield, *supra* note 18, at 294 (describing letters of credit as creatures of contract).

24. A great body of case law, which can be used by analogy, exists in Great

other law to govern their transaction.²⁵ No explicit conflict rules exist, however, on letter of credit choice of law issues.²⁶

In light of the increased use of letters of credit,²⁷ uniformity in international letter of credit law is essential.²⁸ Two major sets of rules govern or supplement letter of credit transactions, the UCP²⁹ and the UCC.³⁰

A. The Uniform Customs and Practices for Documentary Credits

1. Background

The UCP details operations for letter of credit transactions, and is applied in more than 160 countries,³¹ including the United States, Hungary, Ghana, Japan, Fiji, and Uruguay.³² This worldwide usage illustrates that the UCP is the primary guide to letter of credit transactions.³³ The majority of parties adhering to the UCP make specific reference to it in their inter-

Britain. See WHITE & SUMMERS, *supra* note 3, § 19-3, at 822.

25. See *id.* § 19-3, at 818.

26. *Id.* § 19-3, at 822-23; see also Roger J. Gewolb, *The Law Applicable to International Letters of Credit*, 11 VILL. L. REV. 742, 753 (1966).

27. Task Force on the Study of U.C.C. Article 5, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 BUS. LAW. 1521, 1531 (1990) [hereinafter *Task Force Report*] (noting unprecedented expansion in use of letters of credit). More letters of credit are written in New York than in any other state, a large share being international. See WHITE & SUMMERS, *supra* note 3, § 19-3, at 822; James E. Byrne, *The Revision of U.C.C. Article 5: A Strategy for Success*, 56 BROOK. L. REV. 13, 26 (1990).

For example, a court used a letter of credit to ensure that a child would be returned by his father in Germany to his mother in Minnesota pursuant to a custody agreement following the parents' divorce. *Tischendorf v. Tischendorf*, 321 N.W.2d 405, 408 (Minn. 1982), *cert. denied*, 460 U.S. 1037 (1983).

28. JEAN STOUFFLET, *LE CRÉDIT DOCUMENTAIRE* 91 (1957) ("Si l'on tente de caractériser le Droit du crédit documentaire, il apparaît que sa profonde tendance à l'unité internationale en est le trait essentiel.") (emphasis in original) (If one endeavors to characterize the law of the documentary credit, it appears the profound tendency toward international unity is essential in the future).

29. INTERNATIONAL CHAMBER OF COMMERCE, *UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS* (International Chamber of Commerce Publication No. 400, 1983).

30. Rev. U.C.C. art. 5 (1990).

31. See generally Busto, *supra* note 6, at 299 (indicating worldwide participation).

32. See *Worldwide List of Countries, Banks Adhering to UCP*, LETTER OF CREDIT UPDATE, Dec. 1990, at 29-37.

33. *Id.* at 29.

national letters of credit.³⁴ In so doing, the guidelines of the UCP become terms of the letter of credit, in the same fashion as the express terms.³⁵

The UCP is neither a statute nor a code;³⁶ it is a document that reflects custom.³⁷ The rules are the result of the joint efforts of the International Chamber of Commerce (ICC),³⁸ the United Nations, and the banking community, to unify banking custom in letter of credit law.³⁹ The UCP also provides a mechanism for international banking lawyers to become acquainted with the method of current letter of credit practice.⁴⁰

The need to formulate a uniform approach with respect to letters of credit stemmed from the uncertainty of the economy following World War II.⁴¹ The ICC published the UCP for the first time in 1933⁴² and, in response to changes in international trade,⁴³ the ICC amended the UCP in 1983.⁴⁴

34. See U.C.P. art. 1 (1983); see Rubenstein, *supra* note 3, at 139.

35. HARFIELD, *supra* note 15, at 3.

36. Mark A. Wayne, *The Uniform Customs and Practice as a Source of Documentary Credit Law in the United States, Canada, and Great Britain: A Comparison of Application and Interpretation*, 7 ARIZ. J. INT'L & COMP. L. 147, 148 (1989).

37. See Henry Harfield, *An Agnostic View*, 56 BROOK. L. REV. 1, 17 (1990) (noting that the UCP mixes rules with custom, but is clearly not law); see also HARFIELD, *supra* note 15, at 3 (noting that the UCP is custom not law).

38. The ICC is a private organization located in Paris, France. Rubenstein, *supra* note 3, at 138.

39. See KOZOLCHYK, *supra* note 15, at 83-84.

40. See Wayne, *supra* note 36, at 150.

41. See INTERNATIONAL CHAMBER OF COMMERCE, GUIDE TO DOCUMENTARY CREDIT OPERATIONS: INCLUDING UNIFORM CUSTOM AND PRACTICES FOR DOCUMENTARY CREDITS 41 (International Chamber of Commerce Publication No. 415, 1985). The ICC undertook the task of combining bankers' varying perceptions of letter of credit transactions and creating a consistent authority. See KOZOLCHYK, *supra* note 15, at 84.

42. INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS (International Chamber of Commerce Brochure No. 82, 1933), revised by INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS (International Chamber of Commerce Publication No. 222, 1951), revised by INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS (International Chamber of Commerce Publication No. 290, 1974) revised by INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS (International Chamber of Commerce Publication No. 400, 1983).

43. See FRANS P. DE ROOY, DOCUMENTARY CREDITS 12 (1984) (noting that the UCP was updated to stay in line with developments); JAN C. DEKKER, CASE STUDIES ON DOCUMENTARY CREDITS 9 (International Chamber of Commerce Publication No. 459, 1989) (noting continuing revolution in transport technology, communications, and

2. UCP Article 16

UCP article 16(c) allows the issuer a "reasonable" time within which to honor the credit or to notify the presenter of the reasons for dishonoring the documents.⁴⁵ If the issuer fails to comply with the timely notice provisions of the UCP, article 16(e) precludes the issuer from claiming that the documents are nonconforming.⁴⁶ The issuer is estopped irrespective of any detrimental reliance by the beneficiary.⁴⁷ Once the issuer has lost its right to claim that the documents are nonconforming, it is deemed to have honored the documents, mandating payment under the letter of credit to the beneficiary.⁴⁸

B. The Uniform Commercial Code

1. Background

In the United States, article 5 of the UCC also sets forth letter of credit rules.⁴⁹ In many ways, article 5 is a statutory analogue of the UCP.⁵⁰ However, the source of the UCC's letter of credit law stems from contract law, rather than custom.⁵¹

international trade).

44. See DE ROOY, *supra* note 43, at 12. The ICC agreed to the 1983 revision, effective October 1984, after considering input from the United Commission on International Trade Law. *Id.* The 1983 UCP is an interesting change because the 1974 version required that a bank only give notice of dishonor of a letter of credit to the verifying bank. See Rubenstein, *supra* note 3, at 159. The 1983 revision instead requires the bank to notify the beneficiary of dishonor directly to avoid the penalty provided for in 16(e). *Id.*

45. U.C.P. art. 16(c) (1983).

46. U.C.P. art. 16(e) (1983).

47. See generally *Kerr-McGee Chemical Corp. v. Federal Deposit Ins. Corp.*, 872 F.2d 971, 974 (11th Cir. 1989); *Kuntal, S.A. v. Bank of New York*, 703 F. Supp. 312, 314 (S.D.N.Y. 1989); James G. Barnes, *Nonconforming Presentations Under Letters of Credit: Preclusion and Final Payment*, 56 BROOK. L. REV. 103, 103 (1990).

48. U.C.P. art. 16(e) (1983).

49. Rev. U.C.C. art. 5 (1990).

50. See HARFIELD, *supra* note 15, at 4; WHITE & SUMMERS, *supra* note 3, § 19-11, at 881 (finding UCC and UCP complementary). The drafters of the UCC intended the code to stress system, order, and logic to facilitate the business community. See generally WALTER P. ARMSTRONG, JR., *A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS* 78 (1991).

51. See Rev. U.C.C. § 5-101 cmt. 1 (1990). The New York Court of Appeals has described article 5 as a codification of law. See *United Bank, Ltd. v. Cambridge*

The drafters of the UCC based the statute, in part, on the concept that uniformity and certainty in applicable law enhances commercial transactions.⁵² Specifically, they intended article 5 to create an independent legal framework for further development of the law.⁵³ Accordingly, the official comments to the UCC instruct that article 5 be read liberally to promote those underlying policies.⁵⁴

Despite these goals, the banking community has criticized the ineffectiveness of the UCC's article 5.⁵⁵ Bankers wanted an international customary set of rules to solve ordinary problems associated with letters of credit, rather than article 5's codification of the atypical, relatively rare cases.⁵⁶ Conversely, commercial lawyers endorsed article 5, while noting that bankers were only seeking to maximize banking discretion.⁵⁷

A UCC Task Force is now vigorously examining article 5 to determine the adequacy of letter of credit law in the United States.⁵⁸ One of the most notable problems with article 5 stems from the drafters' failure to grasp the significance of the UCP's well-established articulation of letter of credit rule-making and custom.⁵⁹

Four states, including New York, have specifically expressed disfavor with the UCC.⁶⁰ In those states, article 5 contains a nonuniform section 5-102(4)⁶¹ which provides that article 5 has

Sporting Goods Corp., 41 N.Y.2d 254 (1976); *Task Force Report*, *supra* note 27, at 1531 (describing article 5 as codification of case law).

52. Marianne B. Culhane, *The UCC Revision Process: Legislation You Should See in the Making*, 26 CREIGHTON L. REV. 29, 29 (1992).

53. Rev. U.C.C. § 5-101 cmt. 1 (1990).

54. *Id.* § 5-102 cmt. 2.

55. See Byrne, *supra* note 27, at 24.

56. *Id.*

57. *Id.* (noting the disdain between the legal and banking communities).

58. See *Task Force Report*, *supra* note 27, at 1531-44.

59. Byrne, *supra* note 27, at 17.

60. See HILLMAN, *supra* note 5, at 7.

61. For example, New York's section 5-102(4) provides:

Unless otherwise agreed, this Article 5 does not apply to a letter of credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit is subject in whole or in part to the Uniform Customs and Practice for Documentary Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce.

N.Y.U.C.C. LAW § 5-102(4) (McKinney 1984). This provision was also adopted in Alabama, Arizona, and Missouri. See ALA. CODE § 7-5-102(4) (1993); ARIZ. REV. STAT. ANN. § 47-5-102(4) (1984); MO. ANN. STAT. § 400.5-102(4) (Vernon Supp. 1993).

no application where a letter of credit is subject in whole or part, to the UCP.⁶² Despite this provision, however, courts in New York and elsewhere have held that, where the UCP is silent or ambiguous, parties may resort to analogous UCC sections.⁶³

2. UCC Section 5-112

Under UCC section 5-112, an issuer has three banking days within which to honor a letter of credit.⁶⁴ If the issuer does not honor within the specified time, it is deemed to have dishonored the letter of credit.⁶⁵ The issuer must advise the presenter that the documents are being held for the presenter or must return the documents, but need not specify reasons for dishonor.⁶⁶

The issuer may raise the documents' nonconformities as a defense in a beneficiary's suit for wrongful dishonor.⁶⁷ Where the documents fail to conform to the letter of credit's terms, the beneficiary should prevail if it can show the traditional elements for estoppel.⁶⁸

62. See HILLMAN, *supra* note 5, at 7.

63. See *United Bank, Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254 (1976); *Algemene Bank Nederland, N.V. v. Soysen Tarim Urunleri Dis Ticaret Ve Sanayi, A.S.*, 748 F. Supp. 177, 181 (S.D.N.Y. 1990) (applying UCC by analogy to credit subject to UCP); *Prutscher v. Fidelity Int'l Bank*, 502 F. Supp. 535 (S.D.N.Y. 1980) (authorizing application of UCC to a UCP letter of credit); *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1542 (S.D.N.Y. 1985) (utilizing Code by analogy), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); *Banque De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.* 787 F. Supp. 1416, 1421 (S.D. Fla. 1991), *aff'd*, 959 F.2d 971 (11th Cir. 1992); see also *Rosenblith, supra* note 6, at 309. But see *Fertico Belgium, S.A. v. Phosphate Chem. Export Ass'n*, 473 N.Y.S.2d 403, 405 (1st Dept. 1984) (subjecting credit to UCP makes UCC inapplicable); *WHITE & SUMMERS, supra* note 3, § 19-1, at 807 n.3 (stating that UCP complements UCC, but sometimes displaces it).

64. Section 5-112(1) of the UCC provides:

(1) A bank to which a . . . demand for payment is presented under a credit may without dishonor . . .

(a) defer honor until the close of the third banking day following receipt of the documents; and

(b) further defer honor if the presenter has expressly or impliedly consented thereto.

Failure to honor within the time here specified constitutes dishonor . . . of the credit.

Rev. U.C.C. § 5-112(1)(a), (b) (1990).

65. *Id.* § 5-112(1)(b).

66. See *Barnes, supra* note 47, at 104 (explaining process for dishonor).

67. *Id.*

68. See JOHN F. DOLAN, *THE LAW OF LETTERS OF CREDIT* ¶ 4.06 [2][c], at 4-30 (2d ed. 1991). The elements of estoppel include change of position of the parties so

C. Letter of Credit Jurisprudence

Much of the case law construing the interplay between the UCC and UCP in international letter of credit litigation holds that three days represent the typical time within which an issuer must review documents to notify the beneficiary of honor or dishonor. Further, the issuer's period for giving notice does not vary with the usefulness of such notice. Finally, an issuer's consultation with its customer regarding waiver of documentary discrepancies does not enlarge the timely notice provisions under the UCP.

1. The Three-Day Rule of Thumb: *Bank of Cochin v. Manufacturers Hanover Trust Co.*

In *Bank of Cochin v. Manufacturers Hanover Trust Co.*,⁶⁹ Vishwa Niryat Ltd. (Customer) requested Bank of Cochin Limited (Issuer), an Indian corporation, to issue a letter of credit covering up to \$798,000 for the purchase of aluminum scrap, for the benefit of St. Lucia Enterprises, Ltd. (Beneficiary).⁷⁰ The 1974 revision of the UCP⁷¹ controlled the letter of credit which had an expiration date of April 15, 1980.⁷²

Beneficiary allegedly shipped the aluminum on May 29,

that the party against whom estoppel is being invoked received a benefit, or that the party invoking the doctrine relied to its detriment. See generally *Amwest Sur. Ins. Co. v. Republic Nat'l Bank*, 977 F.2d 122, 127 (4th Cir. 1992), cert. denied, 113 S. Ct. 1582 (1993).

69. 612 F. Supp. 1533 (S.D.N.Y. 1985), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986). For a discussion of the case, see David L. Tank, Comment, *Bank of Cochin Ltd. v. Manufacturers Hanover Trust: "Quasi-Strict" Compliance of Documents, Issuer's "Supervisory Core," and "Reasonable Delay" Under Letters of Credit*, 18 U. MIAMI INTER-AM. L. REV. 535, 556-59 (1987).

70. *Cochin*, 612 F. Supp. at 1534.

71. The court explained that application of the 1983 UCP would favor Confirming Bank, but would not alter the result of the case. *Id.* at 1534 n.3. The 1974 version of the UCP read in relevant part:

d) The issuing bank shall have a reasonable time to examine the documents and to determine as above whether to make such a claim.

e) If such claim is to be made, notice to that effect, stating the reasons therefore, must, without delay, be given by cable or other expeditious means to the bank from which the documents have been received

Id.

72. *Id.* at 1534.

1980, from West Germany to Bombay, India.⁷³ On June 9, 1980, Beneficiary presented the documents required by the letter of credit to Manufacturers Hanover Trust Company (Confirming Bank).⁷⁴ Confirming Bank reviewed the documents, found them to be conforming, and on June 13, 1980, paid Beneficiary.⁷⁵

Issuer immediately reimbursed Confirming Bank, but did not receive the documents until June 21, 1980.⁷⁶ Unfortunately, Beneficiary, who disappeared after receiving payment, shipped nothing to Customer. The documents were fraudulent in every regard.⁷⁷ By telex dated July 3, 1980, Issuer asked Confirming Bank to recredit its account and advised Confirming Bank that it was returning the documents.⁷⁸

Confirming Bank responded by telex of July 14, 1980 that Issuer had failed to timely specify documentary discrepancies as required by the UCP.⁷⁹ On July 9, 1985, Issuer sued Confirming Bank in the U.S. District Court for the Southern District of New York for wrongful honor of letter of credit.⁸⁰ The district court granted Confirming Bank's motion for summary judgment, holding that failure to notify Confirming Bank within the reasonable time required by the UCP estopped Issuer from asserting the discrepancies in the letter of credit.⁸¹

The court reasoned that, while the UCP did not specify what constituted a reasonable time for an issuer to determine if documents are defective, the court could use analogous and consistent UCC provisions where the UCP was silent or ambiguous.⁸² Because the UCC provided for a period of three banking days, that time was the maximum allowable for Issuer in *Bank*

73. *Id.* at 1535.

74. *Id.* Among the required documents were signed invoices, bills of lading, notification of shipment, maritime insurance, and a certificate confirming the quality and quantity of scrap metal. *Id.* at 1534 n.1.

75. *Bank of Cochín v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1536 (S.D.N.Y. 1985), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986).

76. *Id.*

77. *Id.* The bills of lading and quality certifications were issued by nonexistent corporations. *Id.*

78. *Id.*

79. *Id.*

80. *Id.* at 1533.

81. *Bank of Cochín v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533 (S.D.N.Y. 1985), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986).

82. *Id.* at 1542.

of *Cochin* to notify Confirming Bank whether the documents were being honored or rejected.⁸³ Accordingly, Issuer's failure to notify Confirming Bank of its decision to dishonor for over a week beyond three days—which potentially prevented Confirming Bank and Issuer from curing the defects prior to the letter of credit's expiration—precluded Issuer's recovery.⁸⁴

The Court of Appeals for the Second Circuit affirmed the lower court's ruling with a similar rationale, but on different grounds.⁸⁵ The twelve or thirteen-day period from Issuer's initial inspection of the documents under the letter of credit to its notification of the defects was a failure to act without delay.⁸⁶ Thus, the court did not need to decide whether it should read the UCC's three-day time frame into the UCP's reasonable time requirement.⁸⁷ The court of appeals concluded that the UCP effected the fundamental policy of promoting certainty in commercial transactions.⁸⁸

2. The Usefulness of the Notice Is Immaterial: *Bank De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.*

In *Banque De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.*,⁸⁹ Banque De L'Union Haitienne (Issuer) on March 3, 1989, issued a letter of credit at the request of Eleck S.A. (Customer), for the benefit of International Basic Economic Co. (Beneficiary).⁹⁰ The letter of credit was subject to the UCP, and was to expire on April 30, 1989.⁹¹

On April 24, 1989, Beneficiary presented its documents to Manufacturers Hanover International Banking Corporation (Confirming Bank).⁹² Confirming Bank ultimately found the documents conforming, transferred \$1,473,189 to Beneficiary's

83. *Id.* at 1542-43.

84. *Id.* at 1543.

85. *Bank of Cochin, Ltd. v. Manufacturers Hanover Trust Co.*, 808 F.2d 209, 213 (2d Cir. 1986); *Tank*, *supra* note 69, at 558.

86. *Cochin*, 808 F.2d at 213.

87. *Id.*

88. *Id.*

89. *Banque De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.*, 787 F. Supp. 1416 (S.D. Fla. 1991), *aff'd*, 959 F.2d 971 (11th Cir. 1992).

90. *Banque De L'Union Haitienne*, 787 F. Supp. at 1418.

91. *Id.*

92. *Id.* at 1419.

account in Miami, Florida, and debited Issuer's account for that same amount.⁹³ On the following day, Beneficiary wire transferred the money overseas and disappeared.⁹⁴ On or about April 27, 1989, Confirming Bank forwarded the documents to Issuer.⁹⁵ On May 8, 1989, Issuer notified Confirming Bank by telex that the documents were nonconforming and that it was seeking repayment from Confirming Bank.⁹⁶

On February 27, 1991, Issuer sued Confirming Bank in the U.S. District Court for the Southern District of Florida for improper payment on an international letter of credit.⁹⁷ The district court granted Confirming Bank's motion for summary judgment, holding that Issuer's violation of the timely notice provisions of the UCP prevented recovery.⁹⁸

The district court reasoned that, while Issuer was in receipt of the nonconforming documents three days prior to the letter of credit's expiry, it unjustifiably failed to give notice of dishonor to Confirming Bank until eight days after the expiration date.⁹⁹ Accordingly, Issuer violated the rationale set forth in *Bank of Cochín*,¹⁰⁰ which provided that the UCC's three-day rule should be the maximum reasonable time under the UCP.¹⁰¹

The court concluded that one of the purposes of the UCP's timely notice provisions was to give a beneficiary the opportunity to cure defects prior to the expiration of the letter of credit.¹⁰² However, the fact that the defects could not have been cured in this case did not excuse Issuer's obligation to give timely notice because Issuer's duty to provide prompt notice was in no way connected with the *usefulness* of such notice.¹⁰³ Rather, the UCP's timeliness requirements served as rules of traffic, enforcing certainty and integrity in international letter of

93. *Id.*

94. *Banque De L'Union Haitienne, S.A. v. Manufacturers Int'l Banking Corp.*, 787 F. Supp. 1416, 1419 (S.D. Fla. 1991), *aff'd*, 959 F.2d 971 (11th Cir. 1992).

95. *Id.*

96. *Id.*

97. *Id.* at 1416.

98. *Id.*

99. *Id.* at 1421.

100. 612 F. Supp. 1533, 1543 (S.D.N.Y. 1985), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986).

101. *Banque De L'Union Haitienne, S.A. v. Manufacturers Int'l Banking Corp.*, 787 F. Supp. 1416, 1421 (S.D. Fla. 1991), *aff'd*, 959 F.2d 971 (11th Cir. 1992).

102. *Id.* at 1422-23.

103. *Id.* at 1423.

credit commerce.¹⁰⁴

3. The Impropriety of Considering Customer's Potential Waiver in Determining the Time for Issuer to Act: *Bankers Trust Co. v. State Bank of India*

In *Bankers Trust Co. v. State Bank of India*,¹⁰⁵ Bankers Trust Co. (Issuer) issued a letter of credit in favor of the Steel Authority of India (Beneficiary), at the request of Harlow & Jones, Limited (Customer).¹⁰⁶ The letter of credit was subject to the 1983 revision of the UCP.¹⁰⁷

On September 3, 1988, Beneficiary shipped four consignments of steel from India to Customer.¹⁰⁸ On September 9, 1988, Beneficiary presented to State Bank of India (Confirming Bank) more than 967 documents purporting to comply with the letter of credit's terms.¹⁰⁹ Confirming Bank paid Beneficiary upon presentment and forwarded the documents to Issuer.¹¹⁰ On September 14, 1988, Issuer reimbursed Confirming Bank, but prior to receipt and review of the mailed documents.¹¹¹

Issuer received the documents in London on September 12, 1988 and found several discrepancies.¹¹² Rather than provide notice of the nonconformities to Beneficiary or Confirming Bank, Issuer on September 26, 1988 forwarded the documents to Customer, who discovered more discrepancies.¹¹³ After Customer refused to waive the nonconformities, Issuer on September 30, 1988, by telex to Confirming Bank, rejected the documents and demanded repayment.¹¹⁴ Confirming Bank refused to reimburse Issuer claiming that Issuer's rejection was entirely in

104. *Id.* at 1424.

105. [1991] 1 Lloyd's Rep. 587 (Q.B.), *appeal dismissed*, [1991] 2 Lloyd's Rep. 443 (C.A.).

106. *Bankers Trust Co. v. State Bank of India*, [1991] 1 Lloyd's Rep. 587, 589 (Q.B.).

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Bankers Trust Co. v. State Bank of India*, [1991] 1 Lloyd's Rep. 587, 589 (Q.B.).

112. *Id.*

113. *Id.*

114. *Id.* at 590.

violation of UCP article 16.¹¹⁵

On December 29, 1988, Issuer sued Confirming Bank for wrongfully honoring Beneficiary's nonconforming documents.¹¹⁶ The court ruled in favor of Confirming Bank, reasoning that Issuer exceeded a reasonable time in examining the documents and failed to determine on the basis of the documents alone whether the documents conformed to the letter of credit.¹¹⁷

On June 13, 1991, the English Court of Appeals affirmed the lower court's ruling, finding eight days to be an unreasonable time for Issuer's document examination.¹¹⁸ The court reasoned that a bank of Issuer's sophistication could finish review in substantially less time than it actually took.¹¹⁹

The appeals court stated that the customary banking practice in the United Kingdom, and the position taken by the ICC Banking Commission, was to fix three days as the reasonable time under UCP's article 16.¹²⁰ Further, in the United States, the UCC explicitly provided for a three-banking-day rule.¹²¹ Accordingly, Issuer had violated both the spirit of the UCP and the letter of the UCC.¹²²

The court concluded by emphasizing that the UCP restricted Issuer's examination to the face of documents.¹²³ As such, a reasonable time for Issuer could not be extended to allow for Customer's potential waiver of the documents' discrepancies.¹²⁴

115. *Id.*

116. *Bankers Trust Co. v. State Bank of India*, [1991] 1 Lloyd's Rep. 587, 590 (Q.B.).

117. *Id.* at 588.

118. *Bankers Trust Co. v. State Bank of India*, [1991] 2 Lloyd's Rep. 443, 444 (C.A.).

119. *Id.*

120. *Id.* at 448.

121. *Id.*

122. *Id.*

123. *Bankers Trust Co. v. State Bank of India*, [1991] 2 Lloyd's Rep. 443, 451 (C.A.).

124. *Id.* at 452.

III. *ALASKA TEXTILE CO., INC. v. CHASE MANHATTAN BANK, N.A.: RAISING UNANTICIPATED RISKS FOR LETTERS OF CREDIT*

A. *Facts*

Alaska Textile, a New York-based company, exports fabric from India.¹²⁵ In early 1988, Lloyd Williams Fashions, Inc., a women's clothing manufacturer, contracted to purchase silk from Alaska Textile's Indian location for delivery and use in the buyer's Hong Kong-based operation.¹²⁶

At Lloyd Williams Fashions' request, Chase Manhattan Bank issued two letters of credit in Alaska Textile's favor for \$82,500 and \$47,141.25.¹²⁷ On April 2, 1988, Alaska Textile shipped the fabric from India to Hong Kong, pursuant to Lloyd Williams Fashions' order, but did not present the documents under the letters of credit to Merchants Bank of New York¹²⁸ until April 26, 1988.¹²⁹ While reviewing the documents for submission to Chase Manhattan Bank, Merchants Bank's examiner found the documents to be untimely¹³⁰ and nonconforming.¹³¹

Alaska Textile acknowledged its noncompliance with the letter of credits' terms, but it nevertheless directed Merchants Bank to forward the documents to Chase Manhattan Bank.¹³² On April 27, 1988, Merchants Bank presented the documents "on an approval basis,"¹³³ to indicate that Alaska Textile was

125. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1140 (S.D.N.Y. 1991), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

126. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

127. 777 F. Supp. at 1140.

128. Merchants Bank of New York, in its capacity as a "collecting bank," acted as an agent of the seller of goods for purposes of presenting the documents and receiving payment.

129. *Alaska Textile*, 982 F.2d at 817.

130. Because they were presented more than twenty-one days after the date that Beneficiary shipped the goods, Collecting Bank considered the documents to be incurably "stale." *Alaska Textile*, 982 F.2d at 817. For timing rules, see U.C.P. arts. 46-49, 51-53 (1983).

131. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

132. *Id.*

133. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1140 (S.D.N.Y. 1991), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

requesting Chase Manhattan Bank to have Lloyd Williams Fashions waive the discrepancies and authorize payment.¹³⁴ Chase Manhattan Bank reviewed the documents under the two letters of credit on the third and fourth banking days following Merchants Bank's presentment.¹³⁵ While Chase Manhattan Bank discovered discrepancies which would justify immediate dishonor,¹³⁶ it asked Lloyd Williams Fashions whether it would waive the nonconformities.¹³⁷

On May 9, 1988, eight banking days after Merchants Bank's presentment, Chase Manhattan Bank told Merchants Bank that the discrepancies warranted dishonor, but that Lloyd Williams Fashions remained undecided as to the question of waiver.¹³⁸ On May 18, 1988, fifteen banking days after presentment, Chase Manhattan Bank formally dishonored the letters of credit, by way of telecommunication to Merchants Bank.¹³⁹

B. The Court's Analysis

1. Documents on Collection

The unanimous court began its analysis by discussing two points of agreement between the district court and the parties. First, Alaska Textile's (Beneficiary) submission of documents on an approval basis meant that the documents were nonconforming. Second, Beneficiary requested Chase Manhattan Bank (Issuer) to ask Lloyd Williams Fashions (Customer) to waive the discrepancies¹⁴⁰ and authorize Issuer's payment on

134. *Id.*

135. *Alaska Textile*, 982 F.2d at 817.

136. *Id.*

137. *Id.*

138. *Id.*

139. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1140 (S.D.N.Y. 1991), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

140. The UCP does not preclude an issuer from notifying its customer of a nonconforming presentation, but the issuer must dishonor promptly. See Vincent M. Maulella, *UCP Art. 16 Proposal on Notifying the Applicant*, LETTER OF CREDIT UPDATE, April 1991, at 6. There are some practical reasons for allowing issuers to seek their customer's waiver of nonconformities. For example issuing banks in the United States indicate that at least 50% of documentary submissions are nonconforming. *Id.* Soviet commentators contend that where documents fail to conform to credit terms, the issuer should not be permitted to seek a waiver of the discrepancies from its customer because of the nation's need to prove itself as reli-

the letter of credit.¹⁴¹ The legal implications of submitting the documents on approval presented the court with an issue of first impression.¹⁴² The court noted the lack of authority on the matter, and summarily analogized presentment of documents on approval with presentment of documents "on collection."¹⁴³

The court explained that submitting documents on collection could mean two different things.¹⁴⁴ First, the term could mean, as the court found in *Alaska Textile*, that Beneficiary submitted documents subject to the letter of credit and the UCP, but with a request that Issuer ask Customer to waive the documents' nonconformities.¹⁴⁵ Alternatively, presentation on collection could mean the documents were being sent on a basis independent of the letter of credit and, therefore, subject to the Uniform Rules for Collections.¹⁴⁶

2. Criticism of the Court's Documents on Collection Analysis

The ICC, which drafted, revised, and implemented the UCP, stated that the handling of documents on a collection basis obviates the issuer's obligation to advise the beneficiary of discrepancies.¹⁴⁷ The issuer's duty on collection would be limited to the transition of the documents for discretionary collecting and payment by its customer.¹⁴⁸ Therefore, contrary to the court's finding, Issuer could not have been acting on collection because Issuer's own apparent belief that it had a duty to give notice of

able in international trade. See George M. Armstrong, Jr., *Letters of Credit in East-West Trade: Soviet Reception of Capitalist Custom*, 17 VAND. J. TRANSNAT'L L. 329, 363 (1984).

141. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.* at 818-19.

146. This would be the case if the bank were acting *solely* as its customer's agent. *Id.*

147. See generally *Rheinberg Kellerei GmbH v. Brookfield Nat'l Bank of Commerce Bank*, 901 F.2d 481, 481 (5th Cir. 1990) (requiring collecting bank to notify issuing bank without delay); INTERNATIONAL CHAMBER OF COMMERCE, UNIFORM RULES FOR COLLECTIONS art. (B)(i) (International Chamber of Commerce Publication No. 322, 1978) (defining collection as handling documents for acceptance or rejection upon instructions received).

148. See generally *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682, 717 n.4 (1976) (acting as an agent); *Beef Neb. Inc. v. United States Dept. of Agr.*, 807 F.2d 712, 717 (8th Cir. 1986) (handling documents only for collection).

the documents' discrepancies to Merchants Bank (Collecting Bank) on May 9, 1988¹⁴⁹ belies the argument. Further, under the ICC's definition of presentation on collection,¹⁵⁰ the court could not logically conclude that Issuer was both acting on a collection basis and bound by the UCP, because article 16(c) requires an issuer to notify a beneficiary of nonconformities.¹⁵¹ Finally, the court failed to explain why or how documents presented on approval amount to the "functional equivalent"¹⁵² of documents submitted on collection.

3. A "Reasonable Time" for Dishonor

Despite its inconsistent logic with respect to documents submitted on collection, the court appropriately determined that Beneficiary's submission of documents on an approval basis did not vitiate Issuer's obligations, under the UCP, to advise of discrepancies in a timely fashion.¹⁵³ Having dispensed with the arguments that Issuer was not bound to strictly comply with the UCP, the Second Circuit proceeded to determine whether article 16's requirements were met.¹⁵⁴

The court explained that under article 16(c), an issuer has a reasonable time within which to accept or refuse a beneficiary's documents.¹⁵⁵ Further, an issuer's failure to act within the reasonable time would render the documents honored under article 16(e).¹⁵⁶

The court next emphatically rejected Beneficiary's contention that Issuer had a maximum of three days to dishonor, as

149. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

150. *See Rheinberg Kellerei GmbH v. Brookfield Nat'l Bank of Commerce Bank*, 901 F.2d 481, 481 (5th Cir. 1990).

151. *See* U.C.P. art. 16(c) (1983).

152. *Alaska Textile*, 982 F.2d at 818.

153. *Id.* at 819.

154. *Id.* at 820.

155. *Id.*

156. *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 820 (2d Cir. 1992). Article 16(e) states:

If the issuing bank failed to act in accordance with the provisions of paragraphs (c) and (d) of this Article and/or fails to hold the documents at the disposal of, or to return them to the presenter, the issuing bank shall be precluded from claiming that the documents are not in accordance with the terms and conditions of the credit.

U.C.P. art. 16(e) (1983).

set forth in UCC 5-112(1).¹⁵⁷ The *Alaska Textile* court acknowledged that the UCC could supplement unclear or silent provisions of the UCP,¹⁵⁸ but reasoned that article 16(c)'s reasonable time, while imprecise, was not ambiguous, and could be determined from the nature and circumstances of the situation.¹⁵⁹ The Second Circuit found that a reasonable time was a fluid concept dependent upon the factual scenario of each case.¹⁶⁰

4. Criticism of the Court's "Reasonable Time" Analysis

The holding defeats the parties' expectations, is contrary to the majority precedent, and disrupts the parties' risk allocation.

a. Meeting the Parties' Expectations

As the court stated, certainty is the hallmark of the letter of credit.¹⁶¹ This concept rests upon objective, practicable standards.¹⁶² In the international financial community and under the UCP, this means that a beneficiary is assured payment unless the issuer communicates *prompt* dishonor, in line with the parties' expectations.¹⁶³

Furthermore, commercial and banking law have long associations with standards of good faith¹⁶⁴ and due diligence. When

157. *Alaska Textile*, 982 F.2d at 821.

158. *Id.* at 822.

159. *Id.* at 823-24.

160. *Id.*

161. *Id.* at 815.

162. See generally *Auto Servicio San Ignacio, S.R.L. v. Compania Anonima Venozolana De Navegación*, 765 F.2d 1306, 1310-11 (5th Cir. 1985); Boris Kozolchyk, *Strict Compliance and the Reasonable Document Checker*, 56 BROOK. L. REV. 45, 78 (1990) (noting global financial market place requires uniform operating guidelines).

163. See Robert M. Rosenblith, *Lawyer Robert M. Rosenblith Looks at UCC Provisions Against UCP Rule*, 6 LETTER OF CREDIT UPDATE, Feb. 1990, at 11, 11-12; *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1543 (S.D.N.Y. 1985) (expecting parties to live up to their obligations), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); Harfield, *supra* note 18, at 295; see generally *Bank, supra* note 69, at 542 (noting that drawing bright lines promotes certainty).

164. See generally *TransAmerica Delaval, Inc. v. Citibank, N.A.*, 545 F. Supp. 200, 205 n.5 (S.D.N.Y. 1982) (issuer owes duty of good faith to beneficiary); *Occidental Fire & Casualty v. Continental Bank, N. A.*, 918 F.2d 1312, 1317 (7th Cir. 1990) (requiring of banks general obligation of good faith in commercial settings); Robert M. Rosenblith, *Letter-of-Credit Practice: Revisiting Ongoing Problems*, 24 UCC L.J. 120, 126-27 (1991) (imposing duties of good faith and reasonable care).

a customer chooses a sophisticated bank as the issuer,¹⁶⁵ the law could require the bank to rise above those standards. Therefore, a beneficiary should expect a bank diligently and properly running a letter of credit operation to pay or claim defects in no more than three days.¹⁶⁶ To conclude otherwise, eviscerates the parties' expectations and violates the UCP.

b. Precedent Demonstrates that Three Days Are Reasonable

As the district court in *Alaska Textile* found, it is common New York banking practice to construe article 16(c)'s timing requirement to mean three banking days.¹⁶⁷ Three days is also the standard applied by most courts throughout the United States.¹⁶⁸

Courts follow the three-day rule because it is an adequate

165. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 815 (2d Cir. 1992).

166. Rosenblith, *supra* note 163, at 12 (noting that needing more than three days indicates issuer's lack of sophistication).

167. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1141; (S.D.N.Y. 1991), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 815 (2d Cir. 1992); *Bank of Cochiti, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F.Supp. 1533, 1539 (S.D.N.Y. 1985) (finding three days the maximum allowable time), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); *see generally* Rosenblith, *supra* note 6, at 330.

168. *See Banque De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.*, 787 F. Supp. 1416, 1421 (S.D. Fla. 1991) (noting three days typically the maximum), *aff'd*, 959 F.2d 971 (11th Cir. 1992); *Occidental Fire & Casualty Co. v. Continental Ill. Nat'l Bank & Trust Co.*, 918 F.2d 1312, 1318 at n.3 (7th Cir. 1990) (interpreting UCC three-day rule as harmonious with UCP reasonable time); *Auto Servicio San Ignacio, S.R.L. v. Compania Anonima Venezolana De Navegación*, 765 F.2d 1306, 1308-09 (5th Cir. 1985) (finding no conflict between UCC three-day, and UCP, reasonable time); *Integrated Measurement Sys., Inc. v. International Commercial Bank of China*, 757 F. Supp. 938, 947 (N.D. Ill. 1991) (holding ten days too late under Article 16); *Petra Int'l Banking Corp. v. First Am. Bank*, 758 F. Supp. 1120, 1128 (E.D. Va. 1991) (giving notice one year late far too long), *aff'd*, 953 F.2d 1383 (4th Cir. 1992); *Banco Do Brasil, S.A. v. City Nat'l Bank*, 17 UCC Rep. Serv. 2d (Callaghan) 840 (Fla. Dist. Ct. App. 1992) (delaying one year too long); *Crocker Commercial Serv., Inv. v. Countryside Bank*, 538 F. Supp. 1360, 1363-64 (N.D. Ill. 1981) (approaching credit's expiry could shorten three-day rule); *AmSouth Bank, N.A. v. Martin*, 559 So. 2d 1058, 1065 (Ala. 1990) (noting UCC's 5-112 could supersede UCP's reasonable time); Busto, *supra* note 6, at 303 (noting United States courts use the three-day rule); *Task Force Report*, *supra* note 27, at 1600 (indicating courts bridge UCP reasonable time to UCC three-day time). But compare a Polish professor's view that a strict interpretation of letter of credit laws makes commercial transactions inflexible. *See generally* A. Szpunar, *Przedawnienie Roszczen Wekslowych*, 45 PRZEG STAW GOSPAD no. 93-98 (1992) (Pol.).

period for the issuing bank to complete its limited obligation of documentary review. Further, where an issuer gives notice within three days, a beneficiary will usually have time to cure documentary defects before the letter of credit expires.¹⁶⁹ A delayed notice could impair the beneficiary's ability to mitigate losses.¹⁷⁰ But as articulated in *Banque De L'Union Haitienne*, even where documents are incurable, courts still prefer the timely notice requirement¹⁷¹ to maintain commercial stability. Also, an issuer is not permitted to defend its delayed communication to a beneficiary on grounds that it sought a waiver from the customer.

In *Alaska Textile*, Beneficiary specifically notified Issuer of the documents' discrepancies.¹⁷² Arguably, Issuer's task of reviewing the documents for nonconformities was, therefore, made easier, perhaps shortening the typical three days within which banks must examine documents. Accordingly, the Second Circuit's definition of a "reasonable time" was contrary to the purpose of letters of credit and the majority of precedent articulating the rules.

c. Risk Allocation and the Independence Doctrine

The court's standard of reasonableness also abrogated the independence principle fundamental to letters of credit and disrupted the parties' risk allocation. It is well established that any request by an issuer for waiver by its customer is independent of its obligation to give timely notice to a beneficiary under article 16(c).¹⁷³

169. Rosenblith, *supra* note 4, at 90.

170. See generally Rosenblith, *supra* note 163, at 12 (timing is critical for diverting goods in transit).

171. *Banque De L'Union Haitienne, S.A. v. Manufacturers Hanover Int'l Banking Corp.*, 787 F. Supp. 1416, 1423 (S.D. Fla. 1991) (rejecting incurability as bearing on notice requirement), *aff'd*, 959 F.2d 971 (11th Cir. 1992); *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1543 (S.D.N.Y. 1985) (failing to notify not excused by incurability), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank*, 707 F.2d 680, 684-85 (2d Cir. 1983) (noting usefulness of notice immaterial); *Pro-Fab Inc. v. Vipa, Inc.*, 772 F.2d 847, 854 (11th Cir. 1985) (rejecting "usefulness of notice" contention).

172. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

173. See Rosenblith, *supra* note 4, at 89 (explaining waiver outside of the credit); see also *Bank of China v. Chan*, 937 F.2d 780, 786 (2d Cir. 1991) (obligating issuer to pay independent of other claims); *All Service Exportação Impoctação Comercio*,

In a recent case¹⁷⁴ on facts similar to *Alaska Textile*,¹⁷⁵ the English Court of Appeals in *Banker's Trust* explained, "[a] reasonable time for the bank to examine the documents cannot be extended by a further period of time to enable the customer to examine the documents."¹⁷⁶ Under a similar rationale, the U.S. Court of Appeals for the Second Circuit held in *Bank of Cochín*¹⁷⁷ that the reasonable time does not include a period for the issuer and customer to "ride the market."¹⁷⁸ Therefore, Beneficiary's mere act of asking Collecting Bank to present documents on approval¹⁷⁹ could not have vitiated or altered Issuer's independent obligation for prompt notice under the UCP.

Even if the court's facts and circumstances test for a reasonable time for dishonor were appropriate, the risk should have fallen on the best cost-avoider. A letter of credit is one item on a menu of services banks offer in order to induce beneficiaries and customers to rely on it as their financial institution. While no consideration is required to establish a letter of credit, banks understandably include commissions and other customary charges in their customer reimbursement agreements.¹⁸⁰ The court would have more properly placed the risk on the issuer who uses letters of credit as a method to attract and build business, and who should be familiar with the services it offers and charges.

Courts typically apply general contract principals to letter of credit transactions.¹⁸¹ When faced with ambiguity, courts construe letters of credit as strongly as reasonably possible against

S.A. v. Banco Bamerindus Do Brasil, S.A., 921 F.2d 32, 35 (2d Cir. 1990) (distinguishing issuer's duty to beneficiary from duty to customer).

174. *Bankers Trust Co. v. State Bank of India*, [1991] 2 Lloyd's Rep. 443, 449 (C.A.).

175. 982 F.2d 813 (2d Cir. 1992).

176. See *Banker's Trust Co. v. State Bank of India*, [1991] 2 Lloyd's Rep. 443, 449 (C.A.).

177. 808 F.2d 209 (2d Cir. 1986).

178. *Id.* at 212.

179. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 118 (2d Cir. 1992).

180. See BURTON V. MCCULLOUGH, LETTERS OF CREDIT § 3.06[1] (1993). Customary charges for items such as cable fees are as low as one percent of the amount of the letter of credit, and commissions are typically .25%. *Id.* It is a letter of credit's low expense that make the financing device an attractive service for a bank to offer to its customers. *Id.*

181. See *Zeevi & Sons, Ltd. v. Grindlays Bank Ltd.*, 371 N.Y.S.2d 892, *cert. denied*, 423 U.S. 866 (1975).

the issuer.¹⁸² In *Alaska Textile*, no facts suggest that the parties provided an express term in their private agreements to indicate the time within which Issuer had to review the documents.¹⁸³ The parties did incorporate the UCP by specific reference,¹⁸⁴ however, so that its guidelines became terms of the letters of credit, in the same manner as the express terms did.¹⁸⁵

Because the Second Circuit was unwilling to apply the UCC three-day rule, it should have at least construed a "reasonable time" against the Issuer. Under that approach, it would be unfair for the court to place the burden on Beneficiary, where Issuer failed to notify Beneficiary of dishonor until fifteen days after presentment.¹⁸⁶

5. Consequence of Dishonor and Bastardizing the UCP

The Second Circuit court in *Alaska Textile* went on to assert that the UCC and the UCP were incompatible because the bodies of law had two radically different approaches to the consequences of dishonoring a letter of credit.¹⁸⁷

The court further stated that the imposition of the UCC's three-day rule into the UCP's reasonable time was unacceptable, because UCC section 5-112(1)(b) authorized relaxation of the three-day rule when the parties consent.¹⁸⁸ Therefore, the reading of a strict three-day rule into the UCP would resemble neither authority, with the effect of "bastardizing" them both.¹⁸⁹

182. See *Bank of China v. Chan*, 937 F.2d 780, 786 (2d Cir. 1991) (interpreting ambiguities against bank); *Barclay Knitwear, Inc. v. Kingswear Ent. Ltd.*, 533 N.Y.S.2d 724, 727 (N.Y. App. Div. 1988) (construing letter of credit against issuer so that beneficiary can comply); *Banco Español de Crédito v. Bank & Trust Co.*, 385 F.2d 230, 237 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968) (reading credit against the drafter); *Timber Falling Consultants, Inc. v. General Bank*, 751 F. Supp. 179, 182 (D. Or. 1990) (interpreting letter of credit in favor of beneficiary).

183. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813 (2d Cir. 1992).

184. *Id.* at 817.

185. See U.C.P. art. 2 (1983); Rubenstein, *supra* note 3, at 139.

186. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 821 (2d Cir. 1992).

187. *Id.* at 822.

188. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 823 (2d Cir. 1992).

189. *Id.*

In its analysis, however, the *Alaska Textile* court failed to explain why the divergent results of dishonor under the UCC, as opposed to the UCP, mandated a divergent approach for the time within which an issuer should review documents. Nor did the *Alaska Textile* court explain why that distinction was not important in the analysis of the same court's decision in *Bank of Cochín*.¹⁹⁰

Finally, the court improperly suggested that UCC section 5-112(1)(b) warranted application in *Alaska Textile*, because Beneficiary never consented to having the review period relaxed through submission of its documents on approval.¹⁹¹

IV. SUBSEQUENT DEVELOPMENTS AND COMMENT

Two recent cases from the U.S. District Court for the Southern District of New York have cited to *Alaska Textile*¹⁹² without adopting the circuit court's rationale.

In *Optopics Laboratories Corp. v. Savannah Bank of Nigeria, Ltd.*,¹⁹³ Ashford Laboratories contracted to sell Mabson Pharmaceutical, Ltd. (Customer), a Nigerian importer, \$32,265 worth of cold capsules.¹⁹⁴ Customer established a letter of credit to effect payment to Optopics Laboratories, Inc. (assignee of the payments and Beneficiary) with a government-owned bank, Savannah Bank of Nigeria (Issuer).¹⁹⁵ On March 22, 1993, Beneficiary brought an action against Issuer for nonpayment of the letter of credit in the U.S. District Court for the Southern District of New York.¹⁹⁶ The court held that Beneficiary was entitled to entry of summary judgment in its favor, as well as payment and prejudgment interest under the letter of credit.¹⁹⁷

The district court cited to *Alaska Textile*¹⁹⁸ for a descrip-

190. 808 F.2d 209 (2d Cir. 1986).

191. *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 817 (2d Cir. 1992).

192. 982 F.2d 813 (2d Cir. 1992).

193. 816 F. Supp. 898 (S.D.N.Y. 1993).

194. *Id.* at 901.

195. *Id.*

196. *Id.* at 898.

197. *Id.*

198. 982 F.2d 813 (2d Cir. 1992).

tion of the basic function of a letter of credit.¹⁹⁹ Unlike *Alaska Textile*, however, the *Optopics* court looked to an analogous provision of the UCC²⁰⁰ to determine the appropriateness of pre-judgment interest under a letter of credit because the UCP was silent or ambiguous on the subject.²⁰¹

In *Full-Bright Industrial Co., Ltd. v. Lerner Stores, Inc.*,²⁰² Hunting National Bank (Issuer) issued two letters of credit in favor of Full-Bright Industrial Co. (Beneficiary), a Korean-based manufacturer of ladies' wear, at the request of Lerner Stores (Customer), a retail women's clothing chain.²⁰³ Customer established the letters of credit to cover the purchase price of garments to be delivered from Korea to the United States.²⁰⁴

On April 8, 1993, Beneficiary sued Issuer in the U.S. District Court for the Southern District of New York to recover on the letters of credit.²⁰⁵ While Beneficiary admitted the documents contained discrepancies, it claimed Issuer was estopped from claiming dishonor because of the delay in rejecting the documents.²⁰⁶

The district court held that Issuer, by waiting seven and ten days, respectively, before notifying Beneficiary of the documents' discrepancies, acted unreasonably in violation of the UCP, so that Beneficiary was entitled to payment.²⁰⁷

The majority opinion cited *Alaska Textile*,²⁰⁸ (without approving or disagreeing with the reasoning), for the proposition that the reasonableness of time for dishonor depends on the circumstances of each case.²⁰⁹ The court in *Full-Bright*, however, flatly disapproved of the propriety of considering Issuer's seeking a waiver from Customer in the determination of a rea-

199. *Optopics*, 816 F. Supp. at 907.

200. New York UCC provides that the beneficiary's measure of damages for wrongful dishonor is the same as a seller's damages upon a buyer's breach of contract. N.Y.U.C.C. LAW § 5-115(1) (McKinney 1984).

201. *Optopics*, 816 F. Supp. at 909.

202. 818 F. Supp. 619 (S.D.N.Y. 1993).

203. *Id.* at 621.

204. *Id.* at 619-20.

205. *Id.* at 619.

206. *Id.* at 621.

207. *Full-Bright*, 818 F. Supp. at 622.

208. 982 F.2d 813 (2d Cir. 1992).

209. *Full-Bright*, 818 F. Supp. at 622.

sonable time for dishonor.²¹⁰

V. CONCLUSION

As a case of first impression,²¹¹ the Second Circuit Court of Appeal's decision in *Alaska Textile* departed from the majority of established letter of credit jurisprudence in violation of the UCP, and raised more questions than it answered. First, the *Alaska Textile* decision is inexplicably inapposite to the same court's prior rationale in *Bank of Cochín*. Second, the court offers no guidance as to which characteristics of a letter of credit transaction should be imputed into the "reasonable time" test.

For example, when determining the limits of an issuer's reasonable time to dishonor documents, should the sophistication of the parties;²¹² the number or type of documentary discrepancies;²¹³ the financial status of the parties;²¹⁴ and the nature and marketability of the goods²¹⁵ be factors? Also, what degree of importance should a court place on each of these relevant considerations.

Even if the reasonable period test was workable, the court should have construed the letters of credit against Issuer, who is in the business of making money through offering banking services.

It is precisely the international nature of letter of credit transactions which requires a formalist approach. In the United States, the approximately \$200 billion in outstanding credits

210. *Id.*

211. *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 814 (2d Cir. 1992).

212. *See generally* *Bank of Cochín v. Manufacturers Hanover Trust Co.*, 612 F. Supp. 1533, 1543 (S.D.N.Y. 1985) (noting issuing bank should have anticipated defects), *aff'd on other grounds*, 808 F.2d 209 (2d Cir. 1986); Rosenblith, *supra* note 163, at 12 (suggesting that courts holds banks to a level of sophistication).

213. *See generally* *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank*, 707 F.2d 680, 684-85 (2d Cir. 1983) (rejecting argument that waiver was inapplicable due to incurability of defects).

214. *Alaska Textile Co., Inc. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1140 (S.D.N.Y. 1991) (seeking waiver of discrepancies to enable beneficiary to pay supplier), *aff'd on other grounds sub nom.*, *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 815 (2d Cir. 1992).

215. *See generally* *Bank of Cochín, Ltd. v. Manufacturers Hanover Trust Co.*, 808 F.2d 209, 212 (2d Cir. 1986) (disallowing buyer to review documents while contemplating the marketability of goods).

demonstrates a marked increase from an approximate figure of one-half billion in 1950.²¹⁶ On an international level, the use of letters of credit as a payment mechanism is exploding,²¹⁷ with New York serving as the banking source of the world.²¹⁸

As use of the letter of credit increases, so too does the attendant litigation.²¹⁹ Accordingly, the letter of credit's profitability depends upon certainty and uniformity in the law.

The court's facts and circumstance determination of a reasonable time under the UCP created new risks in letter of credit transactions, and as applied in *Alaska Textile*, placed the loss on the wrong party.

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216. See *Task Force Report*, *supra* note 27, at 1531.

217. See generally *Worldwide List of Counties Adhering to UCP*, 6 LETTER OF CREDIT UPDATE, Dec. 1990, at 29 (indicating universal use of credit mechanism); John F. Dolan, *Changing Commercial Practices and the Uniform Commercial Code*, 26 LOY. L.A. L. REV. 579, 595 (1993) (remarking on dramatic international growth).

218. See *Zeevi & Sons, Ltd. v. Grindlays Bank Ltd.*, 371 N.Y.S.2d 892, *cert. denied*, 423 U.S. 866 (1975).

219. The number of reported cases involving international letter of credit transactions in the United States doubled between 1965 and 1987. See *Task Force Report*, *supra* note 27, at 1532.

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